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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. [redacted] 12

AMERICAN SURETY COMPANY OF NEW YORK, A CORPORATION,

Petitioner,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, A CORPORATION, ET AL.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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J. E. D. YONGE,
DICKSON H. CARTER,
FRANCIS B. CARTER, JR.,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 819

AMERICAN SURETY COMPANY OF NEW YORK, A CORPORATION,

Petitioner and Appellant below,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, A CORPORATION, ET AL.,

Respondents and Appellees below.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

To the Honorable Charles Evans Hughes, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully shows:

I.

Summary Statement of the Matter Involved.

M. J. Gray, trading as Gray Artesian Well Company, entered into a contract with the United States for drilling a well at the Naval Air Station at Pensacola, Florida (R. 8), and in connection therewith gave the bond required

by the Federal statute (40 U. S. C. A., Section 270) to the United States with petitioner, American Surety Company, as surety in the amount of $3,940 to indemnify the United States against loss on account of such contract and with condition that the contractor would promptly make payment to all persons supplying labor and materials used in the prosecution of the work under the contract (R. 19). As a part of the consideration for executing this bond, the contractor gave to petitioner in connection with it a written agreement of indemnity, by Paragraph VII of which he agreed that all monies which might be payable on account of his contract with the United States should be credited on any claim that might be made upon the surety by reason of its suretyship (R. 45). Gray completed the work under the contract, but remained indebted in a substantial sum to respondents who had furnished materials for use in the performance of the contract (R. 5). In a statutory proceeding in the United States District Court in Florida the surety (petitioner) paid into court the total penalty of its bond, $3,940, which in that proceeding was prorated among the creditors of Gray who had supplied him with labor and materials (R. 5); but this was not sufficient to pay these creditors in full, so that Gray remained indebted to them for the balance (R. 5). When Gray completed work on his contract the United States remained indebted to him for a portion of the contract price (R. 5), which amount petitioner sought to recover in a proceeding in the Supreme Court of the District of Columbia (R. 58). Gray had filed a petition in involuntary bankruptcy in the Northern District of Florida and his trustee in bankruptcy intervened in the proceeding in the District of Columbia and on his petition that court, declining to pass upon the surety's right to the fund, turned it over to the trustee in bankruptcy (R. 6). Petitioner filed its claim in the bankruptcy proceeding,

claiming an equitable lien and priority in the said fund (R. 25, 54). The creditors who had furnished materials in the performance of the contract and who claimed a lien on said fund (the respondents here) (R. 6) filed objections to the allowance of the lien or priority claimed by petitioner (R. 48, 60) and the referee in bankruptcy sustained their objection and allowed their claims priority of payment over petitioner (R. 63). The surety then filed its petition for a review by the United States District Court of the referee's order denying it priority (R. 64), and the District Judge sustained the referee's order (R. 66). Petitioner then appealed to the Circuit Court of Appeals for the Fifth Circuit and that court, by its judgment dated February 13, 1935 (R. 89), sustained the order of the District Court, and the writ of certiorari here sought is to review that order of the Circuit Court of Appeals. The substantial question presented to the Circuit Court of Appeals was whether the surety (petitioner here) or the suppliers of materials (respondents here) have the better right to the balance of the contract price which remained in the hands of the United States when the work under the contract was completed.

II.

Reasons Relied On for the Allowance of the Writ.

1. In holding that respondents, as furnishers of materials to the contractor, have a lien upon or prior right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract and that such lien or right is superior to the right of petitioner, as surety on the contractor's bond, to said balance, the said Circuit Court of Appeals rendered a decision in conflict with the Circuit Court of Appeals for the Third Circuit in the case of *American Surety Company v. Finletter*, 274 Fed. 152, on the same matter.

2. In holding that the assignment and indemnity agreement which petitioner took from the contractor upon becoming his surety gave it no lien upon or priority of right in the unpaid balance due the contractor in the hands of the United States upon completion of the construction contract, the said Circuit Court of Appeals rendered a decision in conflict with the Circuit Court of Appeals for the Eighth Circuit in the case of *Exchange State Bank* v. *Federal Surety Company*, 28 F. (2d) 485, and in conflict with the Circuit Court of Appeals for the Fourth Circuit in the case of *National Surety Company* v. *County Board of Education of McDowell County et al.*, 15 F. (2d) 993, and in conflict with the Circuit Court of Appeals for the Third Circuit in the case of *American Surety Company* v. *Finletter*, 274 Fed. 152, on the same matter.

3. In holding that petitioner, as surety on the contractor's bond, was not entitled to subrogation to the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract, the said Circuit Court of Appeals has decided an important question of general law in a way probably in conflict with applicable decisions of this Court.

Wherefore, your petitioner prays that a writ of certiorari issue under the seal of this Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding said court to certify and send to this Court a full and complete transcript of the record and of the proceedings of the said Circuit Court of Appeals for the Fifth Circuit had in the case numbered and entitled on its docket, Number 7382, American Surety Company of New York, a Corporation, Appellant, *vs.* Westinghouse Electric Manufacturing Company, a Corporation, *et al.*, Appellees, to the end that this cause may be reviewed and determined by this Court, as provided for by the statutes

of the United States; and that the judgment herein of said Circuit Court of Appeals for the Fifth Circuit be reversed by the Court, and for such further relief as to this Court may seem proper.

Dated March 20, 1935.

FRANCIS B. CARTER,
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DICKSON H. CARTER,
FRANCIS B. CARTER, JR.,
Of Counsel.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 819

AMERICAN SURETY COMPANY OF NEW YORK, A CORPORATION,

Petitioner and Appellant Below,

vs.

WESTINGHOUSE ELECTRIC MANUFACTURING COMPANY, A CORPORATION, ET AL.,

Respondents and Appellees Below.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinions of Court Below.

The opinion of the Circuit Court of Appeals is printed in the record at page 80 and the dissenting opinion of Circuit Judge Sibley at page 85. These opinions have not yet been reported.

II.

Jurisdiction.

The judgment to be reviewed is a judgment of the United States Circuit Court of Appeals for the Fifth Circuit, dated February 13, 1935 (R. 89). Being a judgment in a civil case

in a Circuit Court of Appeals it is one which under Section 347 of Title 28 of the United States Code may be reviewed by this Court by certiorari upon the petition of any party thereto.

III.

Statement of the Case.

The case has already been stated in the preceding Petition for Writ of Certiorari under I, (p. 1), which statement is hereby adopted and made a part of this brief.

IV.

Specification of Errors.

1. The Circuit Court of Appeals erred in holding that, as against the respondents, petitioner is not entitled to priority of payment of its claim against the estate of the bankrupt contractor, out of the unpaid balance due the contractor remaining in the hands of the United States upon completion of the contract or to a lien upon said balance for its said claim.

2. The Circuit Court of Appeals erred in holding that, as against petitioner, respondents are entitled to priority of payment of their claims against the estate of the bankrupt contractor, out of the unpaid balance due the contractor remaining in the hands of the United States upon completion of the contract.

V.

ARGUMENT.

Summary of the Argument.

Point A. The court below was in direct conflict with the decision of another Circuit Court of Appeals in holding that respondents as furnishers of materials to the contractor

have a lien upon or prior right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract and that such lien or right is superior to the right of petitioner as surety on the contractor's bond.

Point B. The court below was in direct conflict with the decisions of three other Circuit Courts of Appeals in holding that the assignment and indemnity agreement which petitioner took from the contractor upon becoming his surety gave it no lien upon or priority of right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract.

Point C. The court below is in conflict with the applicable decisions of this Court in deciding that the petitioner as surety on the contractor's bond was not entitled by subrogation to the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract.

Point A.

The court below was in direct conflict with the decision of another Circuit Court of Appeals in holding that respondents as furnishers of materials to the contractor have a lien upon or prior right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract and that such lien or right is superior to the right of petitioner as surety on the contractor's bond.

The substantial question presented to the Court of Appeals was whether the surety (petitioner here) or the materialmen (respondents here) had the better right to the fund in question. The accounts of the materialmen had been

partially paid by the pro rata distribution among them of the full penalty of the bond paid into court by the surety and their claims were for the balance due them. The surety claimed on account of the payment it had been required to make under the bond. The fund in controversy was the balance of the contract price remaining in the hands of the United States after the contract was completed.

The Court of Appeals decided that the materialmen had "an enforceable equitable right" to the fund (R. 83, 84) and that such right was superior to the claim of the petitioner (R. 83, 84). Upon both of these points the decision was in direct conflict with the decision of the Circuit Court of Appeals for the Third Circuit in *American Surety Company* v. *Finletter*, 274 Fed. 152. That case involved the construction of public works for the City of Philadelphia. A bond including protection for laborers and materialmen similar to the bond required by the Federal statute and to the one before this Court was given upon an application, in substance, the same as was executed by the contractor here. The surety company paid to the labor and material claimants the full penalty of its bond but that amount was not sufficient to liquidate such claims in full. Both the surety and the materialmen claimed the balance retained by the city, the surety on account of the amounts already paid under its bond and the materialmen on account of the unpaid balance on their claims.

As to the materialmen's right, the court said (text page 155):

> "In this state of the law—laborers and materialmen having no rights to reserved percentages—there were, as to them, no rights to which the Surety Company could be subrogated."

The court further held that the surety was entitled to the fund under its equitable assignment, saying on this point:

"Without discussing the views there expressed with reference to a valid equitable assignment, we are inclined rather to the views of the same court expressed in *Ingersoll* v. *Coram*, 211 U. S. 335, accepting the rule stated in *Walker* v. *Brown*, 165 U. S. 654, to the effect that an express executory contract in writing, whereby the contracting parties sufficiently indicate an intention to make some particular property or fund therein described or identified, a security for a debt or other obligation, creates an equitable lien on the property so indicated."

An examination of the court's opinion in the *Finletter* case will show that the decision there was in favor of the surety and against the materialmen where, as here, the surety had paid the full penalty of its bond to the materialmen without liquidating their claims in full and left them claiming for the remainder in competition with the surety, who claimed, as here, on account of the amounts already paid under its bond. This situation appears in the controversy as to the Fifty-fourth Street Bridge (text 157) and particularly in connection with the claim of American Bridge Company. The bonding company under that particular construction contract had paid the receiver the full amount of its obligation, with which fund the receiver paid a 65% dividend, leaving 35% of the claim of the Bridge Company unpaid. For this balance the Bridge Company came into competition with the Surety Company and the court held against the Bridge Company, just as it had already held against the receiver. But the payment of the whole of the reserved fund to the bonding company did not liquidate its claim in full; for the balance it presented a claim as a general creditor. The Bridge Company likewise presented its claim as a general creditor for the remaining balance of 35% due it after deducting its share of the proceeds of the bond. As between these two claimants

as general creditors, the court held, upon general principles of subrogation, that the bonding company must wait until the other general creditors had been paid in full. It is made entirely clear, however, that this situation arose only after the bonding company had received the whole of the reserved precentage.

Though the *Finletter* case arose under a bond required by a State statute and the bond in the instant case was given under the Federal statute, the bonds and the application therefor and the facts on which the conflicting claims arose are in substance the same in the two cases and the decisions of the two courts of appeal thereon are in direct conflict.

POINT B.

The court below was in direct conflict with the decisions of three other Circuit Courts of Appeals in holding that the assignment and indemnity agreement which petitioner took from the contractor upon becoming his surety gave it no lien upon or priority of right in the unpaid balance due the contractor remaining in the hands of the United States upon the completion of the construction contract.

By express contract with the contractor, made in his application for the bond, petitioner became entitled to the benefit of all monies which might be due under the construction contract for credit upon any claim that might be made against it by reason of its suretyship (R. 45, Paragraph VII). The Court of Appeals, however, declined to give any effect whatever to this agreement, holding that it added nothing to the implied obligation of indemnity. It said:

> "The assignment and the indemnity agreement under which the appellant claims did not have the effect of subordinating the rights of the appellees to those of

the appellant. The contractor being under an implied obligation to indemnify or reimburse the appellant, an express agreement to do so added nothing to appellant's rights."

It is clear that a mere general agreement by the principal to indemnify the surety adds nothing to the obligation implied by law from the relationship; but this ignores all of the other terms of the express contract. In holding that this contract gave the surety no lien or prior right in the fund, the Court of Appeals is in conflict with the courts of appeals in three other circuits, each of which has held that such an agreement gives the surety such a lien or priority.

The Circuit Court of Appeals for the Eighth Circuit had before it in *Exchange State Bank* v. *Federal Surety Company*, 28 F. (2d) 485, an application for a bond containing an indemnity agreement in substance the same as the agreement in the instant case. There the fund remaining in the county's hands was claimed by the surety under an equitable lien based upon the assignment in the contractor's indemnity agreement and was claimed by the appellant bank under an assignment from the contractor to secure a loan of funds used by him for labor and materials. The court held that the surety had an equitable lien on the fund under the assignment agreement and that this lien arose at the time of the execution of the bond and was superior to any claim of the bank.

The Circuit Court of Appeals for the Fourth Circuit had before it in *National Surety Company* v. *County Board of Education*, 15 F. (2d) 993, a case similar to ours, in which the contractor had made an indemnity agreement with the surety in the application for the bond by which the deferred payments and retained percentages and all other moneys that might become due to the contractor under the contract were assigned to the surety. Upon completion of the contract the school board paid over a portion of the unpaid bal-

ance of the contract price to the contractor, another portion to a bank to whom the contractor had made an assignment, and the remainder to persons who had supplied materials to the contractor for the building. The surety sued the board for all of these funds, claiming that it was entitled to an equitable lien upon them in the hands of the county under its assignment. The court held that the surety had such a lien and said.

> "We agree with the standing master that complainant (the surety company) is entitled to a decree for the entire amount of the percentage required to be retained. Complainant's loss under the bond exceeds this amount, and it is well settled that in cases such as this the surety has an equitable lien on the funds required by the contract to be retained from payments to the contractor, to the extent necessary to reimburse the surety for loss sustained under the bond."

After citing and discussing authorities including the *Henningsen* case (hereinafter discussed), the court continued:

> "In the case at bar, not only did the contract provide for the retention by the defendants of 15% of the contract price, but this retained percentage was assigned to plaintiff to secure any loss arising out of the execution of the bond. This assignment unquestionably created in favor of complainant an equitable lien upon the retained percentage so assigned."

The conflicting decision from the Third Circuit is *American Surety Company* v. *Finletter*, 274 Fed. 152, which we have already discussed (pp. 10-12).

We respectfully submit that this conflict of authority as to the legal effect of a form of agreement in common daily use in business should be settled by this Court.

Point C.

The court below is in conflict with the applicable decisions of this Court in deciding that the petitioner as surety on the contractor's bond was not entitled by subrogation to the unpaid balance due the contractor remaining in the hands of the United States upon completion of the construction contract.

The court below held that petitioner was not entitled to the fund in question by subrogation because any subrogation must be to the rights of the respondents as suppliers of materials and, since the whole of their debts had not been satisfied, petitioner could not claim by subrogation through them. This decision was based upon the court's construction of the decision of this Court in *Henningsen* v. *U. S. Fidelity and Guaranty Company*, 208 U. S. 404. That case grew out of a construction contract with the United States under which a bond was given in accordance with the Federal statute including protection for suppliers of labor and materials. The contractor completed the construction but failed to pay certain labor and material claims. The surety paid the full penalty of its bond and those claims were satisfied. Because of this payment the surety asserted a right to the reserved fund held by the United States as against a bank which held an assignment of this fund from the contractor. This Court held that the surety was entitled to the fund in equity.

Following the construction of that case given in *Belknap Hardware & Manufacturing Company* v. *Ohio River Contract Company*, 271 Fed. 144, the Court of Appeals reached the conclusion that this Court had held in the *Henningsen* case, that the rights to which the surety was there held to be subrogated were those of the furnishers of materials. This we submit is an erroneous conclusion. The Court of

Appeals did not consider at all the possibility that the subrogation was to the rights of the contractor, who, having completed the contract, had the right to collect the fund in question. That it was the contractor's right to which the surety was subrogated is expressly stated by the headnote in the official report of the case. This construction is clearly stated in the dissenting opinion below as follows (R. 87):

> "The court in the *Henningsen* case speaks of subrogation but does not say to whose right the surety became subrogated, and the argument is sought to be made that since the contract was completed the United States no longer had any right when the surety paid out its money, so that the subrogation spoken of must have been to some right of the laborers and materialmen, who therefore must have been held to have a lien. But the headnote in the official report states: 'In such a case the surety is subrogated to the *rights of the contractor*, but the bank is not.' If that correctly states the ruling, the rights of the materialmen were not at all considered, and the ruling was that the surety, bound since the date of his contract, was subrogated to *the right of the contractor to collect the balance due* on the completed contract, and the bank's assignment of date later than the contract was inferior, and the bank being a voluntary lender had no possible right of subrogation."

Soon after the decision in the *Henningsen* case this Court again held in *Hardaway* v. *National Surety Company*, 211 U. S. 552, which was on similar facts, that the surety was entitled to the reserved payment by subrogation. Again the opinion did not state to whose rights he was subrogated, but the headnote again stated that it was to the contractors' rights.

This erroneous construction of the holding in the *Henningsen* case has resulted in the denial to petitioner of the right of subrogation; and the decision below should,

we submit, be reviewed to bring it into conformity with the decisions of this Court correctly construed. If there be doubt as to the true meaning of the *Henningsen* decision, a review should be had in this case to ascertain and announce the true rule.

Conclusion.

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers and for the granting of a writ of certiorari and the review and reversal of the decision of the Court of Appeals.

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